



# Explicating the design of overhead absorption procedures in UK organizations

Colin Drury\*, Mike Tayles

<sup>a</sup>*Department of Accountancy, University of Huddersfield Business School, Queensgate HD1 3DH, Huddersfield, UK*

<sup>b</sup>*Business School, University of Hull, Cottingham Road, Hull U6 7RX, UK*

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## Abstract

This paper reports the findings of a postal questionnaire survey that examines the extent to which potential explanatory factors influence the level of complexity of product costing system design choices in UK companies. It is argued that because previous surveys have sought to classify costing systems by two discrete alternatives, either traditional or ABC systems, they do not adequately capture the diversity of practices that exist. The distinguishing feature of this paper is that it adopts a broader perspective and examines cost system design choices that vary along a continuum ranging from very simplistic to highly complex costing systems.

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## 1. Introduction

Most companies have faced significant changes in their business environment over the past 20 years. Deregulation, increasing global competition, decreasing information costs, customers' demands for greater product diversity and the development of integrated enterprise-wide information systems have provided the impetus for many companies to

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\* Corresponding author. Tel.: +44 1484 472299; fax: +44 1484 473062.

*E-mail address:* [j.c.drury@hud.ac.uk](mailto:j.c.drury@hud.ac.uk) (C. Drury).

implement more sophisticated *product* costing systems. These changes have also been reflected in the considerable attention that has been given to the design of *product* costing systems (henceforth referred to a cost system design) in accounting journals, particularly the practitioner oriented journals such as the professional accounting journals. Although relatively less attention has been given to cost system design in the research journals there has, nevertheless, been a dramatic growth in publications relating to this topic over the past 15 years.

Our literature review indicated that virtually all of the research relating to cost system design over the past two decades has concentrated on studying ABC systems. The early ABC literature was mainly concerned with the exposition of ABC developments and theory (Cooper, 1990; Kaplan, 1990; Cooper and Kaplan, 1992). Since the early 1990's many different strands have emerged. One element has been mainly descriptive concentrating on the characteristics and applications of ABC systems and the extent of ABC usage (Innes and Mitchell, 1995; Innes et al., 2000; Friedman and Lyne, 1995). Another element of the literature questions the ability of ABC to generate more accurate product costs. It is argued that ABC can introduce measurement error and product cost distortions when costs are indivisible, non-linear and/or unavoidable (Noreen, 1991; Datar and Gupta, 1994; Yahya-Zadeh, 1997; Maher and Marais, 1998). A third stream has adopted a contingency theory framework and has surveyed practice to examine empirically the antecedents of adoption and non-adoption of ABC (Bjornenak, 1997; Krumwiede, 1998; Malmi, 1999). A more recent theme has examined the organizational factors influencing success and failure of ABC systems (Shields, 1995; Swenson, 1995; McGowan and Klammer, 1997; Malmi, 1997). Finally, some researchers have recently undertaken studies that have examined whether there is an association between using ABC and an improvement in financial performance (Cagwin and Bouwman, 2002; Kennedy and Affleck-Graves, 2001; Gordon and Silvester, 1999).

The specific aim of the paper is to examine the extent to which different explanatory variables influence the level of complexity of product costing cost system design choices in UK companies in terms of assigning indirect costs to cost objects. It is thus related to the contingency stream of research. The earliest forms of this research can be traced to the original structural contingency frameworks developed within organizational theory that focused on the impact of the environment and technology on organizational structure (Woodward, 1965; Perrow, 1970; Lawrence and Lorsch, 1967). Early management accounting researchers drew on this work to investigate the importance of the environment, technology, structure and size on the design of management control systems (see Chenhall, 2003 for a review of this literature). More recently, as indicated above, contingency theory has been applied to examine the factors influencing the adoption ABC systems. A common theme that emerges from the ABC contingency literature is the lack of consistent findings from the empirical surveys. It would appear that the factors influencing the design of product costing systems are poorly understood. This suggests that there is a need for further empirical research into the contextual factors influencing the choice of product costing systems (Abernathy et al., 2001). All of the contingency related survey studies of cost system design have assumed that cost systems consists of two discrete alternatives, either traditional or ABC systems. No contingency survey-based study could be found from the literature review that adopted a wider perspective in examining

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